Conformity to International Provisions of the TCJA in Maine

FTA Revenue Estimating Conference
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Maine Corporate Income Tax

- Water's Edge Income
- Combined reporting
- Pre-TCJA: 50% dividend received deduction (DRD) for dividends from an affiliated corporation that is not part of the Maine combined report
  - Subpart F income is taxable and eligible for DRD
- Dividends in taxable income also added to the denominator of the sales factor (Maine uses single sales factor apportionment)
- Financial institutions pay franchise tax and insurance companies pay premiums tax rather than income tax

I. Deemed Repatriation

- Without conformity, deemed repatriation not included in Maine taxable income

- Final conformity bill (passed 9/2018)
  - Add back participation exemption (C-corp)
  - 80% deduction for deemed repatriation included in Maine taxable income for C-Corps

Deemed Repatriation Estimate

- Starting point is list of public corporations and their estimated amount of deemed repatriation, covers $2.6 trillion of deemed repatriation*
- Match list to Maine 1120s, recalculate liability with 20% inclusion
  - Two changes: Income increases and sales factor falls
- Technical Considerations
  - Sometimes sales factor is missing when return has negative income, find sales factor for earlier return
  - Matching on names can be challenging
    - Corporation files under name of an affiliate, must look at Schedule CR (combined report)

*Theo Francis and Yaryna Serkez, "How the Tax Law Will Affect U.S. Firms Bringing Overseas Money Home," *Wall Street Journal*, January 26, 2018. At https://www.wsj.com/graphics/tax-repatriation/ . The online article contains a list of the estimated repatriation amount for 311 corporations. The analysis is largely based on work by the Zion Research Group.

Deemed Repatriation Estimate (Cont.)

- Account for deemed repatriation not covered by list
  - Cautious about how much to increase revenue estimate for this group
    - Maine possibly underrepresented in residual
    - Don’t have solid estimate of full deemed repatriation
- Timing
  - Little better than guesswork
  - A small number of corporations have tax credit carryforwards that will delay the impact on their liability
  - A large number of corporations routinely overpay and don’t claim refunds, possibly delaying the cash flow impact
- Main Risks
  - Concerns about alternative apportionment
  - Estimate for taxpayers not on C-corp list
- The estimate
  - About $30 million total, $23 million in FY 19

II. FDII deduction, GILTI inclusion, 100% DRD

– Challenges

1) Baseline and interactions

2) Limited data

3) Interpreting the JCT estimates

Challenge #1: Baseline and Interactions

– 100% DRD: Baseline Issues

- Revenue forecast assumes current level of activity, very little revenue from foreign affiliate dividends
- Federal changes: could be significant increase in dividends due to 100% DRD; on the other hand, what's a taxable dividend and what's previously-taxed income (PTI) has changed due to deemed repatriation and GILTI
- Nonconformity: Major differences between what's dividend vs PTI for federal and state purposes
- Stacking: Is estimate before or after conforming to deemed repatriation and GILTI inclusion?

Challenge #2: Limited Data

- Do not have the data required for a sophisticated estimate
- Time constraints
- Challenges understanding the small amount of data we have
  - Potential misreporting on the line for 50% dividends received (i.e. claiming a 100% dividends received deduction for dividends that cannot constitutionally be taxed by the state)
- Limited data → Rely on JCT estimate

Challenge #3: Interpreting JCT Estimate

- Dangers of "scaling down" JCT estimate (beyond question of scalar)
  - JCT estimate includes behavior
  - The behavior would occur regardless of Maine's conformity decision and should be included in a revenue forecast, not a fiscal note
  - Would like to purge JCT estimate of behavior and scale down only direct cost of the deduction/direct revenue increase from GILTI
    - JCT estimate = Revenue(y_1 – deduction) - Revenue(y_0)
    - Want to scale down: Revenue(y_1 – deduction) - Revenue(y_1)
  - Behavior likely very important
    - JCT stacks 100% DRD first in the international section
      - » Base erosion concerns
    - Many of the tax provisions after the DRD are intended to reduce income shifting

Interpreting JCT Estimate (Cont.)

– Example: FDII deduction
  - Possible response to FDII/GILTI regime: Foreign affiliates sells intangible assets to U.S. parent, resulting in increase in Subpart F income for the U.S. corporation
  - FDII deduction estimate in TCJA revenue estimates: Initial increase in revenue!
    – FY 18-21: Raises $18.1 billion
    – FY 22-27: Loses $81.8 billion
  - FDII tax expenditure
    – FY 18-21: Tax expenditure totals $67.3 billion
  - Can’t naively multiply JCT estimate by tax rate and income ratios
    – Conforming to FDII deduction is a tax cut

Conformity Bill

- Conformity Bill
  - Maine conforms to FDII deduction and 100% DRD
  - Maine conforms to GILTI inclusion but not the deduction and instead allows a 50% deduction for GILTI (just like Subpart F)

Conformity Bill Estimate

- 100% DRD based on Maine's history with 50% DRD
  - Baseline did not recognize potential increase in dividends
  - Large share of payments from foreign affiliates to U.S. parent, especially in early years, would be PTI after conforming to repatriation and GILTI
  - The cost of 100% DRD likely increases in out years

- FDII and GILTI estimates based on educated guesses, JCT scores

Lessons learned along the way

- Collaborate with attorneys and auditors
  - Practices that are not written down
  - Learn about disputes related to foreign affiliate dividends
  - Verify understanding of how the law works
- When using historical corporate tax data, if a small number of corporations have outsized influence, try to understand their returns and be especially careful to interpret their data correctly